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CASE STUDIES, READINGS AND MATERIALS

ON

PUBLIC POLICY FORMATION

HON. DONALD S. MACDONALD
J. ROBERT S. PRICHARD
M. A. CHANDLER

FACULTY OF LAW
UNIVERSITY OF TORONTO

VOLUME II
MARCH, 1985

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VI. THE BAILOUT CASE STUDY

I. BACKGROUND DOCUMENT

1. Michael J. Trebilcock, "The Political Economy of Business Bail-outs in Canada," January 10, 1984 VI-1

II. PRIMARY DOCUMENTS

A. Required Readings:

1. Chrysler Case Study - To be distributed in class.

2. Bail-out Table VI-21

READINGS

A. Required Readings:

1. K. Dyson, "The Cultural, Ideological and Structural Context," in K. Dyson and S. Wilks (eds.), Industrial Crisis (1983), pp. 26-65 VI-28

2. "CIRB Plans to Seek More Money to Spur Textile, Footwear Sectors," Globe and Mail VI-68

3. J. Zysman and L. Tyson, American Industry in International Competition: Government Policies and Corporate Strategies (1983), pp. 32-59 VI-69

4. Jack Quinn, "Corporate Reorganization and Strategic Behaviour: An Economic Analysis of Canadian Insolvency Law and Recent Proposals for Reform," 1984 VI-97

FURTHER READINGS:

1. W. Grant, "The Political Economy of Industrial Policy," in R.J.B. Jones Perspectives on Political Economy (1983)

2. P. Maunder (ed.) Government Intervention in the Developed Economy (1970)

3. Journal of Public Policy, Vol. 3, Feb. 1983, Special Issues on Industrial Policies in OECD Countries

4. M. Jenkin, The Challenge of Diversity (1983)

5. H.G. Thorburn, Planning and the Economy (1984)

VII. POLICY EVALUATION

A. Required Readings:

1. Brian Barry and Douglas Rae, "Political Evaluation", in Fred Greenstein and Nelson Polsby (eds.) Handbook of Political Science, Vol. 1, pp. 337-401 VII-1

2. Ronald Manzer, "Policy Rationality and Policy Analysis: The Problem of the Choice of Criteria for Decision-Making," Paper presented to the Workshop on Public Policy and Administrative Studies, University of Guelph, April 13-14, 1984.

3. Grant L. Reuber," The Impact of Government Policies on the Distribution of Income in Canada: A Review,"Canadian Public Policy, Vol. 4, 1978 pp. 505-529 VII-87

Further Readings

1. John G. Grum, "The Analysis of Policy Impact," in Fred Greenstein and Nelson Polsby (eds.) Handbook of Political Science, Vol. 6, pp. 439-466

2. J.M. Jordan and S.L. Sutherland, "Assessing the Results of Public Expenditure: Program Evaluation in the Canadian Government," in Canadian Public Administration 22 (Winter, 1979), pp. 581-609

3. "A Framework for 'A Mutually Compatible Management System" in the Royal Commission on Financial Management and Accountability: Final Report (1979) pp. 31-57.

Michael J. Trebilcock, "The Political Economy of Business Bail-outs in Canada", January 10, 1984

INTRODUCTION

I. The Nature of the Issues

In a market economy, risk-taking by economic agents, both firms and individuals, is an essential feature of the process of resource allocation. At least in theory, the price system appropriately compensates agents for the assumption of risks and creates appropriate economic incentives for the allocation of resources in the light of the risks entailed. However, in the nature of things, negative risks will sometimes materialize and economic agents will be required to bear the costs associated with them. Things may have turned out differently, and if they had, the agents would have been permitted to capture the rewards associated with their risk-taking. This is the essence of entrepreneurship in a capitalist system. In Joseph Schumpeter's memorable phrase, competitive markets involve "a perennial gale of creative destruction".1 In such a process there are both winners and losers but the economic dynamism fostered in a system that encourages private risk-taking will, in the long-run, so it is conventionally claimed, make society, as a whole, materially better off.

It will be obvious that the basic premises of such an economic system would be violated if private economic agents could take risks and capture the rewards if they turned out positively but could systematically shift the costs to others ex post if they turned out negatively. A system which separates the bearing of costs and the

receipt of rewards from private risk-taking would create perverse and highly inefficient economic incentives to cavalier or irresponsible undertaking of activities, whatever the risks, and whatever their potential social value, which would, over time, result in a gross misallocation of society's scarce economic resources. At the limit, it would be tantamount to gambling with other people's money.

In fact in the Canadian economy, while we observe many firms realizing substantial economic successes, we also observe a number of firms failing. In the years 1975 - 1982 the federal Superintendent of Bankruptcy reports that 46,654 businesses went bankrupt. The annual number of new business bankruptcies jumped from 2,958 in 1975 to 10,765 in 1982 (see Table 1):